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Chapter 1: Introduction

History

The Tennessee General Assembly passed the “Business Tax Act of 1971” (the “Act”) as a replacement to a local property tax (commonly referred to as an “ad valorem tax”) imposed on business inventories. However, the Tennessee State Constitution required that inventory be “taxed according to its value,” and thus, Tennessee courts ruled that the Act could not be applied in lieu of the ad valorem tax but instead had to be applied *in addition to* the ad valorem tax.

Because this was not the intent of the General Assembly, in 1971, the General Assembly held a Limited Constitutional Convention to amend Article II, Section 28 of the Tennessee State Constitution. This amendment stated the General Assembly “may levy a gross receipts tax on merchants and businesses in lieu of ad valorem taxes on the inventories of merchandise held by such merchants and businesses.” The amendment became effective in 1973.

As described by the Tennessee Court of Appeals in 1979, the General Assembly desired this shift from a local ad valorem tax to a gross receipts tax, in part, because of following tax disparity:

It is our opinion that one of the purposes of the Constitutional Amendment of 1973 was to prevent repressive taxation whereby unsold inventories of merchants, who most likely had to borrow funds at substantial interest rates to obtain those inventories, would be taxed on an ad valorem basis while such inventories remained unsold in these merchants' hands...¹

The Act eliminated this disparity by allowing merchants to pay the business tax (a tax on gross sales) in lieu of the ad valorem tax. At the time of enactment, the business tax was comprised of two parts – a county-level tax and a city-level tax. In its original form, the appropriate local governmental body had to adopt the tax. Additionally, the local governmental body administered the tax and remitted a portion of the tax collected to the Department of Revenue (the “Department”).

Beginning January 1, 2010, in accordance with Public Chapter 530, 2009 Acts, the Department assumed responsibility for administering and collecting the business tax. All

businesses subject to the tax were to file tax returns with, and remit the tax to, the Department. However, the general structure of the tax remained the same under the 2009 amendment.

Effective January 1, 2014, in accordance with Public Chapter 313, 2013 Acts the structure of the business tax changed. Significantly, Public Chapter 313 changed the county tax to a uniform state-level tax. While the Department still distributes the state-level tax to the counties where a taxpayer performs business, counties no longer adopt or impose the tax. Local municipalities, however, still must adopt a municipal-level tax.

Finally, in 2016, the Revenue Modernization Act (the “RMA”) made the most recent substantial change to the business tax statutes by codifying substantial nexus (see Chapter 2 of this Manual for more information). Subsequent to passage of the RMA, the Department updated sixteen different business tax rules and regulations, including three rules repealed in their entirety.

Brief Business Tax Overview

The business tax statutes are found in Tenn. Code Ann. § 67-4-701 through Tenn. Code Ann. § 67-4-730² and the business tax rules and regulations are found in TENN. COMP. R. & REGS. 1320-4-5-.01 through TENN. COMP. R. & REGS. 1320-4-5-.61.³

The business tax is a privilege tax on the privilege of doing business by making sales of tangible personal property and services within Tennessee and its local jurisdictions. While anyone doing business in the state is subject to the state-level business tax, unless specifically exempt, each municipality must adopt the tax to impose it within its city limits.

The business tax applies to a taxpayer’s gross sales (see Chapter 4 for more information on what constitutes “gross sales”). Taxpayers multiply the gross sales derived from taxable sales per location by the appropriate state and local tax rates to calculate the amount of tax owed per location. There are several different business tax rates. The rates are determined based on the taxpayer’s “dominant business activity” (see Chapter 5 for more information on Classifications) and whether the taxpayer is a wholesaler or a retailer (see Chapter 5 for more information on retailer/wholesalers).

In general, all sales of tangible personal property and services made in Tennessee will be subject to the business tax. However, there are several exceptions and exemptions discussed throughout this Manual.

Nature of the Business Tax

As stated above, the Tennessee business tax is imposed on the privilege of doing business in the state of Tennessee. Unlike sales tax, which principally applies to retail sales of tangible personal property and certain specifically listed services, business tax applies to all taxable, non-exempt sales of services and sales of tangible personal property. Business tax applies at both the retail and wholesale sales. Businesses may invoice the business tax as a separate item and pass it on to its customer, though this amount is included in the sales tax and business tax base.⁴

1. State-Level and Municipal-Level Taxes

Business tax is comprised of two separate but complementary taxes: a state-level tax and a municipal-level tax. Generally, every entity making sales of tangible personal property and/or services in Tennessee is subject to the state-level tax.⁵ Entities may be subject to the municipal-level tax if they have a business location in a municipality that has enacted the tax. The sections below provide a high-level overview of when a business is subject to business tax (see Chapter 2 of this Manual for a more detailed discussion of when a business is subject to business tax by having “nexus” with the state and Chapter 7 for a more detailed discussion on how the tax revenue is distributed).

State-Level Tax

Every person doing business in Tennessee with a physical location or place of business in the state is subject to the state-level business tax unless specifically exempt. For business tax purposes, “person” is defined as an “individual, firm, partnership, joint venture, association, corporation, estate, trust, business trust, receiver, syndicate, or other group or combination acting as a unit.”⁶ The term “person” does not include the United States of America, the State of Tennessee, or any political subdivision of the two; electric membership cooperatives or utility districts.⁷

A person without a physical location or place of business in Tennessee will be subject to the state-level business tax if that person has substantial nexus (see pg. 19) in the state and performs any of the following activities:

- Sells tangible personal property that is shipped or delivered to a location in this state;
- Sells a service that is delivered to a location in this state (see Chapter 4 for more information on services);
- Leases tangible personal property that is located in this state; or
- Makes sales as a natural gas marketer to customers located within this state through the presence in this state of the seller's property, pipeline capacity, or through the presence in this state of the seller's representatives acting on behalf of the seller to solicit orders, provide customer service, or conduct other activities in furtherance of such sales in this state.⁸

Municipal-Level Tax

Each municipality, by passing a resolution or ordinance, may elect to levy the municipal-level business tax on any business activity conducted within its borders.⁹ Currently, 215 municipalities impose the business tax. Unlike with the state-level business tax, a person must have a physical location, place of business, or other location¹⁰ in a municipality to be subject to the municipal-level business tax. If a taxpayer's business is located in a municipality that has enacted business tax, the taxpayer is required to pay both the state-level and municipal-level business tax.

Please see Chapter 11 for special rules that apply to cable, telecom, and other specific industries. The taxpayer should contact the municipality or the county assessor if there is any question that the business may not be inside city limits.

A list of cities imposing business tax is available [HERE](#) on the Department's website.

If a taxpayer's business location is not included on the list, the taxpayer may still be subject to municipal-level business tax. Many areas in Tennessee are governed by and/or part of adjoining incorporated cities. For example, Antioch, Tennessee is not a city on the list, however it is part of Metropolitan Nashville and the Nashville city business tax is due.

Additionally, a county may have a multi-tiered, municipal-level business tax system. For example, Davidson county has a general services district and an urban services district. The city of Nashville is part of the Davidson county urban services district. Taxpayers can

determine if their business is part of an urban services district if they are located in the urban services district for property tax purposes.

Application

1. Doing Business

Business tax is a privilege tax levied upon the privilege of doing business in the state of Tennessee. Business is defined as “any activity engaged in by any person, or caused to be engaged in by the person, with the object of gain, benefit, or advantage, either direct or indirect.”¹¹

Business does not include:

- Occasional and isolated sales (see Chapter 4) by someone not normally engaged in the business of selling the type of property being sold;¹² or
- Utilization of a property management company to manage vacation lodging for overnight property rentals by an individual property owner. However, business tax still applies to the rental of the property. The property management company would be responsible for filing. See the section titled Sales or Rentals of Real Property in Chapter 8 of this manual for more information.

However, business does include any other activity of the individual property owner that is subject to the business tax.

2. Imposition

Business tax is imposed on a business’s gross sales of tangible personal property and services. The vocations, occupations, businesses, or business activities listed in Tenn. Code Ann. §§ 67-4-708(1)-(5) are taxable privileges subject to Tennessee’s state-level business tax. Tenn. Code Ann. §§ 67-4-708(1)-(4) detail the taxable privileges subject to Tennessee’s municipal-level business tax.

For information on vocations, occupations, businesses, or activities subject to business tax, please see Chapter 5 of this Manual. For more information on sales and services that are excluded from business tax and exempted sales, services, or entities, please see Chapter 8 of this Manual.

3. Business Tax Classifications

An entity's business tax classification determines the rate of tax that will apply. Businesses choose their classification for each of their locations based on the "dominant business activity" of the location. "Dominant business activity" is the activity that produces the most taxable income for the business location.¹³

There are five major business tax classifications as well as a separate category for antique malls, flea markets, transient vendors, and the like. Some classifications have subcategories that are discussed in more detail in Chapter 5. Business tax classifications are found in Tenn. Code Ann. § 67-4-708. Only one classification is allowed per business location.

The business tax classifications each contain several business activities that businesses must choose to categorize as their dominant business activity. As the classifications increase in number from Classification 1 up to Classification 5, the types of business activities change in character from activities that meet basic needs such as the provision of food for home preparation in Classification 1 to the relatively small subset of industrial loan and thrift companies in Classification 5.

Businesses engaged in the business activity of selling tangible personal property that is not listed in any other section of Tenn. Code Ann. § 67-4-708 file under Classification 2.¹⁴

Businesses engaged in the sale of services not otherwise specified file under Classification 3.¹⁵

A detailed analysis of the business tax classifications is available in Chapter 5 of this Manual.

4. Retailer vs. Wholesaler

Businesses must also determine if they are primarily engaged in the business of making retail sales or wholesale sales. This is important because the business tax rate differs for retailers and wholesalers. Generally, a business is a retailer if 50% or more of taxable gross sales are retail sales and a wholesaler if more than 50% of taxable gross sales are wholesale sales.¹⁶ For more information on retailers and wholesalers, please see Chapter 5 of this Manual.

¹ *Dixie Rents, Inc. v. City of Memphis*, 594 S.W.2d 397, 399-400 (Tenn. Ct. App. 1979).

² The Tennessee Code Annotated may be accessed for free at the following link:
<https://advance.lexis.com/container?config=014CJAA5ZGVhZjA3NS02MmMzLTRlZWQtOGJjNC00YzQ1MmZlNzc2YWYKAFBvZENhdGFsb2e9zYpNUjTRalWVfyrur9ud&crd=df4206ac-948a-487a-8a8a-8e2c48b8be80&prid=d4c835c1-112a-44d3-b572-9c4bed4ee970>

³ The business tax rules and regulations can be found at the following link:
<https://publications.tnsosfiles.com/rules/1320/1320-04/1320-04-05.20160926.pdf>

⁴ TENN. COMP. R. & REGS. 1320-04-05-.03.

⁵ Tenn. Code Ann. § 67-4-704.

⁶ Tenn. Code Ann. § 67-4-702(a)(13).

⁷ TENN. COMP. R. & REGS. 1320-04-05-.35.

⁸ Tenn. Code Ann. § 67-4-717(a).

⁹ Tenn. Code Ann. § 67-4-704 and 705.

¹⁰ Please see Chapter 11 for special rules that apply to cable, telecom, and other specific industries.

¹¹ Tenn. Code Ann. § 67-4-702(a)(2).

¹² *Id.*

¹³ Tenn. Code Ann. § 67-4-702(a)(5).

¹⁴ Tenn. Code Ann. § 67-4-708(2)(F).

¹⁵ Tenn. Code Ann. § 67-4-708(3).

¹⁶ Tenn. Code Ann. § 67-4-702(a)(16), (25).